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Micro-Incentives and Municipal Behavior: Political Decentralization and Fiscal Federalism in Argentina and Mexico

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Summary. — This article analyzes the mixed results of political and fiscal decentralization in Latin America by comparing taxing and spending policies in six cities in Argentina and Mexico. Consistent with previous studies, we find that decentralization has been frustrated by overconcentration of power at the provincial level and large vertical fiscal imbalances, though we characterize these as functional elements in a system of redistributive policy-making that benefits a wide array of provincial and municipal actors. We seek to add a new dimension to the literature by arguing that micro-level incentives (conditions and circumstances particular to specific places) are more important determinants of municipal behavior than macro-level structures (those policy and institutional changes intended to make officials more responsive to local conditions – federalism, local elections, intergovernmental transfers, and own-source revenues). We conclude that the theory of decentralization relies on a flawed conception of the causal mechanisms that are hypothesized to create responsiveness in local officials.

Key words — decentralization, fiscal federalism, Latin America, Mexico, Argentina

1. INTRODUCTION

Political and fiscal decentralization should have resulted in extraordinary changes in the efficacy of governance in Latin America. The fortuitous coincidence of Hayekian local knowledge, close supervision by voter-consumers, and Tiebout-like interjurisdictional competition, coupled with the efficiency and equity benefits of the proper assignment of functions among the appropriate levels of government, were theorized to break the chains of the failed developmental state. Newly responsive to long-neglected interests, invigorated subnational governments would confine themselves to allocating public goods and apportioning their costs according the benefit principle while chastened central governments would focus on stabilization and redistribution, addressing regional inequalities and limited subnational fiscal capacity with strategically structured transfers (Bird, 1993; Brennan & Buchanan, 1980; Oates, 1972, 1993, 1999; Qian & Weingast, 1997).

The results have failed to live up to the theory. Decentralization has been notably uneven between and within countries, unreliably linked to democratization, subject to reversals, and highly dependent on the "vagaries of local leadership" (Dickovick, 2011; Montero & Samuels, 2004; Tulchin & Selee, 2004, p. 23). Latin American politics are more democratic than in previous centuries but experiments in participatory government in Brazil, Uruguay, Venezuela, and Peru, among other places, have resulted in widely divergent outcomes (Goldfrank, 2011; McNulty, 2011). Notable, though sporadic, successes in service delivery have been difficult to duplicate or sustain as illustrated in Mexico and Brazil (Grindle, 2007; Tendler, 1997). Environmental policies designed to empower and hold accountable local decision-makers and resource users have not resulted in greater efficiency, equity, sustainability, or inclusion (Larsen & Ribot, 2004; Wilder & Romero Lankao, 2006). Subnational governments account for record levels of public expenditure but regional disparities persist and in some cases continue to widen (Garman, Haggard, & Willis, 2001; Montero, 2000; Montero & Samuels, 2004; Willis, Garman, & Haggard, 1999).

Explanations for this equivocal record vary. Theorists admitted that the guidelines for decentralization were far from determinative and would have to be adapted to local conditions; history, culture, and especially politics would play a role in the application of theory to specific cases (Bahl & Linn, 1994; Oates, 1999). In that process, however, the virtues of the ideal type have succumbed to the peculiarities of particular times and places. Political decentralization, far from representing a genuine effort to disperse power, emerged as top-down strategy to preserve the legitimacy and electoral continuity of established central authorities in crisis (Eaton, 2001; Eaton & Dickovick, 2004; Mizrahi, 2004; Tulchin & Selee, 2004; Willis *et al*., 1999). Party elites, wielding power from different locations within national, regional, and local electoral structures, have used decentralization selectively to reinforce their influence, resulting in the persistence of cronyism which undermines accountability (Garman *et al*., 2001; Grindle, 2007; Montero & Samuels, 2004; Willis *et al*., 1999). Fiscal decentralization, often prompted by central government efforts to off-load burdensome services or to reduce debt, occurred with so many operational caveats and to such a limited degree that subnational officials rarely ended up with the authority necessary to control either local revenues or local spending (Escobar-Lemmon, 2001; Falleti, 2004; Gibson, 2004; Mizrahi, 2004; Smulovitz & Clemente, 2004; Willis *et al*., 1999). Extreme differences in provincial and local fiscal capacity necessitate redistribution mechanisms that sustain huge vertical fiscal imbalances and encourage rent-seeking in spite of elaborate efforts to design transfer systems with the correct incentives (Gervasoni, 2010; Rodden, 2004). Political, fiscal, and administrative decentralization have unfolded independently of each other, leaving subnational governments with an incomplete toolbox for addressing responsibilities

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formerly in the hands of distant national officials (Falleti, 2010). Jurisdictional boundaries, the products of historical and cultural idiosyncrasies, are not designed for efficient service delivery or revenue collection (Oates, 1999).

In this article, we argue that this mixed record of decentralization in practice is due to flaws in decentralization theory itself.[1] We compare fiscal management in six cities in Argentina and Mexico – two federalist countries with different relationships between national and subnational governments – to illustrate four interrelated points. First, using Hirshman's (1970) "exit" and "voice" framework, we show that neither of the causal mechanisms of decentralization theory correctly describes how decisions are made in the cities and provinces in our study. Second, we argue that these causal mechanisms are not evident in actual practice because decentralization theory is based on the mistaken notion that allocation is the proper role of subnational governments whereas a review of what provincial and municipal officials actually do suggests that redistribution is their preferred activity. Third, rather than conforming to decentralization theory, the redistributive efforts of subnational officials are driven by what we call micro-incentives: idiosyncratic conditions and circumstances particular to specific places that create opportunities for redistributive policies both to advance personal careers and to serve client groups. In other words, micro-incentives are more important determinants of subnational behavior than those macro-level policy and institutional structures – federalism, local elections, intergovernmental transfers, and own-source revenues – intended to make officials more responsive to local conditions. Fourth, we speculate that two key features typically described as emblematic of the incompleteness of decentralization – the overconcentration of power at the provincial level and the persistence of vertical fiscal imbalances – play an integral role in the redistributive practices of subnational officials and thus should be interpreted not as evidence of a "stalled" process of decentralization but as quite functional elements of an expanded system of resource redistribution.

The article is divided into eight sections. Following this introduction, we summarize the causal logic of decentralization theory. The third part of the essay reviews existing literature on Argentina and Mexico with an emphasis on the presumed incompleteness of decentralization. In the forth section, we present our rationale for using a case study approach as a preface to our description of taxing and spending practices in Santa Fe, Argentina, and Guanajuato, Mexico, in the fifth and sixth sections of the article, respectively. The seventh section reassesses the role of "exit" and "voice" in decentralized governance in light of our case material. We conclude with a discussion of the implications of our study for understanding the central role of redistributive activities in the partially decentralized state in Latin America.

2. "EXIT AND "VOICE IN THE THEORY OF DECENTRALIZATION

Although theories of democratic decentralization and fiscal federalism rely on different motivational mechanisms, they proceed from a similar behavioral premise: a firm conviction in the power of macro-level institutional structures to create incentives in the form of "exit" and "voice" that shape the actions of subnational officials (Bird, 1993; Hirshman, 1970; Oates, 1993).[2] In short, decentralization produces responsiveness. The three major schools of thought supporting decentralization – the electoral model, the market model, and the fiscal efficiency model – are thus united by what might be called the median public official theorem: both elected and appointed officials become more responsive to the demands of voter-consumers as the distance between them decreases because proximity increases the potency of sanctions.[3] According to this theory of causation, public officials in a decentralized system must respond or lose their jobs; to keep their jobs, therefore, they become more responsive to local tastes and preferences and thus more accountable to local taxpayers.[4] Bolstering each theory are arguments regarding the deficiency of the alternative to decentralization: a historical record of failure by the centralized state which undermines whatever theoretical benefits might by claimed by its advocates and which vitiates whatever dangers (corruption at the local level, for example) might be associated with decentralization (Prud'homme, 1995). Taken together, these approaches offer a collection of clear behavioral expectations about the effect of macro-level structures on local officials which, as our case studies will show, are not matched by the actual practice of subnational governance.

The electoral model of decentralization proceeds from the notion that competition at the ballot box prompts public officials to be as responsive as possible to voters. Unlike national elections, where central authorities might form winning coalitions even if they ignore or alienate local constituencies, local elections force politicians to placate a large segment of the local population which can effectively sanction politicians for their lack of responsiveness by voting against them (Faguet, 2014). Even where a history of undemocratic political culture or the persistence of authoritarian practices results in weak electoral competition, citizens can use other methods to pressure local officials, from popular protest and lobbying to petitions and grass-roots organizing (Cleary, 2007). Voters "throw the rascals out" or line up at their door; in every instance, public officials are compelled to act in accordance with local demands (Bird, 1993).

Advocates of the market model have little faith in the electoral system or in the inclination of public officials, left to their own devices, to distribute public goods and apportion their costs appropriately. In the market model, "voice" (political expression, whether voting or petitioning) is replaced by "exit." "The act of moving or failing to move is crucial," according to Tiebout (1956), since that "replaces the usual market test of willingness to buy a good" (p. 420). Although the shorthand for Tiebout's argument describes citizens as "voting with their feet," it would be more accurate to say that the political act of voting is replaced by the non-political act of moving, thus depoliticizing public service provision by transforming it into a market. In this spirit, public choice theorists are even more explicit in their attempt to replace politics by the market and "voice" by "exit." "The principle of federalism emerges directly from the market analogy," Buchanan insists (1995, p. 21). "To the extent that allocative and distributive choices can be relegated to the workings of markets, the necessity for any politicization of such choices is eliminated" (pp. 19–20). Public officials only become responsive in this scenario because voters (now recast as consumers) can abandon their jurisdictions; consumers exercise their "exit option" and thus force competition among public-sector actors just as occurs in the private market. Under the market model, then, consumers choose among competing territorially based packages of public services and taxes. That competition for consumer-voters goads public officials to responsiveness.

The efficiency argument for fiscal decentralization proceeds from more specifically normative premises while borrowing both sanction-by-"voice" and sanction-by-"exit" motivations. As developed by Musgrave (1959) and Oates (1972, 1999), fis-